

the Town of Kiawah Island (the Town), the Kiawah Island Community Association, Inc. (the Association), and the Kiawah Island Inn and Golf Companies (Inn and Golf).

The Commission Staff (the Staff) made on-site investigations of the Company's facilities, audited the Company's books and records, and gathered other detailed information concerning the Company's operations. The other parties likewise conducted their discovery with regard to the rate filing of Kiawah.

A public hearing relative to the matters asserted in the Company's Application was held on February 4, 1999 in the Hearing Room of the Commission at 101 Executive Center Drive, Columbia, South Carolina. Pursuant to S.C. Code Ann. Section 58-3-95 (Supp. 1998), a panel of three Commissioners composed of Commissioners Saunders, Mitchell, and Clyburn was designated to hear and rule on this matter. G. Trenholm Walker, Esquire represented the Company; Elliott F. Elam, Jr., Esq. and Charles M. Knight, Esquire represented the Consumer Advocate; Frank R. Ellerbe, III, Esquire, represented the Town; Michael A. Molony, Esquire, represented KPOG, the Association, and Inn and Golf. The Commission Staff was represented by F. David Butler, General Counsel and Jocelyn D. Green, Staff Counsel.

The Company presented the testimony of Robert J. Azari, James Mitchell Bohannon, III, Townsend P. Clarkson, Becky Dennis, and Barry Gumb. The Consumer Advocate presented no witnesses. KPOG presented the testimony of Jean C. Hiestand. William H. Miller testified on behalf of the Town. The Association presented the testimony of Vaughan E. Delk. Walter T. Cuthbert and John Weitz (adopting the testimony of Prem A. Devadas) testified for Inn and Golf. The Staff presented the testimony of Thomas L. Ellison and Robert W. Burgess.

FINDINGS OF FACT

1. The Company is a water and sewer utility operating in the State of South Carolina and is subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. Section 58-5-10 (1976) et seq. Kiawah Island Utility, Inc. is owned by Kiawah Resort Associates, L.P. (KRA).

2. As of December 31, 1997, the Company provided water service to 2,916 residential and commercial customers and sewer service to 2,548 residential and commercial customers on Kiawah Island, Charleston County, South Carolina.

3. The Company purchases its water from St. Johns Water Company, Inc. The Company has three ground level storage tanks with a capacity of 4.5 million gallons, along with support equipment for the pumping and metering of the water supply and distribution system. The Company's sewer system is comprised of gravity collection mains, force mains, and treated effluent transfer mains, aggregating approximately 58 miles, 40 sewage pumping stations, and a wastewater treatment facility.

4. The Company's present rates and charges were approved by Order No. 97-4, dated January 8, 1997, in Docket No. 96-168-W/S.

5. At present, the Company has six rate schedules relating to its water and sewer charges and other miscellaneous service charges. The Company's residential water service charge is \$18.00 per month for a minimum bill of 0 to 2,000 gallons. All water consumed over 2,000 gallons per month is billed at a rate of \$2.10 per 1,000 gallons. The Company presently charges a flat rate for residential sewer of \$22.00 per month. The Company's tap fees are \$500 for both water and sewer for residential customers with a

5/8 inch meter. Tap fees and Basic Facility charges are based on meter size for residential customers and other classes of customers.

The Company's present rates and proposed rates are depicted in Hearing Exhibit No. 15, Exhibit A of the Water and Wastewater Department's exhibits in the Commission Staff Report. In lieu of discussing all proposed changes in the Company's six rate schedules, the Commission will highlight the changes requested. The Company proposes to increase the residential water service charge to \$22.40 per month for a minimum bill of 0 to 2,000 gallons. All water consumed over 2,000 gallons up to 11,000 gallons per month would be billed at a rate of \$2.17 per 1,000 gallons. Water consumed over 11,000 gallons per month and up to 50,000 gallons per month would be billed at a rate of \$2.65 per 1,000 gallons. All water consumed over 50,000 gallons per month would be billed at a rate of \$2.90 per 1,000 gallons. The Company proposes to modify its sewer rates to a basic facilities charge of \$18.00 per month for a 5/8 inch water meter (and more for various size water meters) and a consumption charge based on water usage of \$.47 per 1000 gallons, capped at 11,000 gallons. The Company has also proposed various changes in its other schedules.

6. The Company asserts that its requested rate increase is required because of several reasons. First, according to Company witness Clarkson, Kiawah has incurred increased costs associated with purchased water from St. John's Water Company. Since 1995, these costs have increased by 20.2%. Further, according to Clarkson, an average of roughly 100 homes are being built per year on Kiawah. This means that the Company has to constantly extend its service lines and expand the equipment and other facilities necessary to serve this increasing demand. In addition, Clarkson notes that the Company

must pay for capital cost, improvements and maintenance of the 45 miles of transmission lines and related delivery facilities of St. John's on Johns Island. The utility pays according to its total percentage usage of the total potable water available at the delivery point. This share is currently 60 percent. Further, Clarkson states that the Company has operated at an overall loss since 1994.

7. The Company proposes that the appropriate test period to consider its requested increase is the twelve-month period ending December 31, 1997. The Staff concurred in using the same test year for its accounting and pro forma adjustments. The Intervenor did not contest the test year.

8. The Company seeks an increase in its rates and charges for water and sewer service which would result in an operating margin of 8.03% per Staff and 9.50% per the Company.

9. Under the Company's presently approved rates, the Company's operating revenues, after accounting and pro forma adjustments are \$3,061,700. The Company seeks an increase in its rates and charges for water and sewer service in a manner which would increase its operating revenues by \$489,151.

10. Under its presently approved rates, the Company's total operating expenses for the test year, after accounting and pro forma adjustments, are \$2,616,752. The Company and the Staff all proposed certain adjustments to the Company's books and records. The Company ultimately endorsed adoption of the Staff's adjustments. These are explained in some detail below.

11. Under its present rates, the Company's net operating income is \$444,948. Applying customer growth of \$8,657, the Company's total operating income is \$453,605. After considering interest of \$421,458, an operating margin of 1.05% results.

12. The Commission will use the operating margin as a guide in determining the lawfulness of the Company's proposed rates and the fixing of just and reasonable rates.

13. A fair operating margin that the Company should have the opportunity to earn is 6.50%, which is produced by the appropriate level of revenues and expenses found reasonable and approved herein.

14. This operating margin is produced through additional revenues of \$300,114 for a total revenue under the new rates of \$3,361,814. The Commission approves \$117,510 in additional expenses, for a total of \$2,734,262. Net Operating Income of \$627,552 is then produced. Applying customer growth of \$12,307, Net Operating Income is \$639,859. Interest to be considered for the operating margin is \$421,458. This includes accounting and pro forma adjustments which reflect the sale of a well at the Ocean Golf Course and the removal from cost of service of an amount equal to the capitalized tap fee expenses.

15. The rate designs and rate schedules approved by the Commission as described herein are appropriate and should be adopted.

16. The rates and charges depicted in Appendix A, attached hereto and incorporated by reference, are approved and effective for service rendered on and after the date of this Order.

EVIDENCE AND CONCLUSIONS

EVIDENCE AND CONCLUSIONS FOR FINDINGS

OF FACT NOS. 1, 2, 3 AND 4.

The evidence supporting these findings concerning the Company's business and legal status, number of customers, water purchasing practices, and the Company's last rate increase are contained in the testimony of the witnesses, the Company's application, and in prior Commission Orders in the docket files of which the Commission takes judicial notice. The Company is a water and sewer utility under S.C. Code Ann. Section 58-5-10 and is providing water and sewer service in its approved service area in Charleston County, South Carolina. The Company's operations are subject to the jurisdiction of this Commission. These findings of fact are essentially informational, procedural, and jurisdictional in nature, and the matters that they involve are essentially uncontested.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 5 AND 6

The evidence supporting these findings of fact are included in the Company's Application and Company testimony presented at the hearing. Many of the matters contained therein were contested by the parties, and more discussion will appear infra thereon.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NO. 7

The evidence for this finding concerning the appropriate test period is contained in the Company's Application and in the testimony and exhibits of the Company witnesses, the witnesses for the intervenors, and the Staff's witnesses. The Company proposed in its Application that the appropriate test year by which to consider the

requested rate increase was the twelve month period ending December 31, 1997, and based the filing on that time period. Relying on the Company's proposed test year, the Staff witness utilized the same test period for their accounting and pro forma adjustments.

A fundamental principle of the ratemaking process is the establishment of a historical test year period. While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable out-of-test-year changes in expenses, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. See Parker v. South Carolina Public Service Commission, 280 S.C. 310, 313 S.E. 2d 290 (1984), citing City of Pittsburgh v. Pennsylvania Public Utility Commission, 187 P.A. Super. 341, 144 A.2d 648 (1958); Southern Bell v. The Public Service Commission, 270 S.C. 590, 244 S.E. 2d 278 (1978). Based on the record, the Commission finds the twelve month period ending December 31, 1997, to be the reasonable and appropriate period for which to make its ratemaking determinations herein.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 8

The evidence supporting these findings of fact are included in the testimony and exhibits of the Commission Staff presented at the hearing, more of which will be discussed below.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF

FACT NOS. 9, 10, AND 11

The Commission believes that the Company should receive an additional \$300,114 in revenue in this case. The Company and the Commission Staff were the only two parties that presented accounting testimony in this proceeding. Ultimately, the Company consented to the Staff's adjustments. Consequently, while we are mindful of the cross-examination of Staff witness Ellison with regard to several of these adjustments, we believe that Ellison's testimony constitutes substantial evidence in the record of this case for adoption of the Staff's adjustments by this Commission. Further explanation is given below.

With regard to adjustments to operating revenue and expenses, the Commission would discuss the following:

(A) DHEC Fees

Staff removed the Department of Health and Environmental Control required recoupment fees from revenues and expenses. Ellison noted that such fees are billed to the Company's customers as a separate line item on a customer's bill, and are intended to recover the cost of certain water testing functions required by State law. Accordingly, Staff proposed removal of \$(7,516) in expenses and \$(7,699) in revenues associated with such fees, since such fees are recovered by the Company through charges that are not regulated by this Commission.

(B) Non-allowables

Ellison testified that Staff found, during the audit, certain expenses paid that Staff would disallow for ratemaking purposes in addition to the \$595 removed by the Company. These included a wreath (\$28), a going away gift, lunch and golf (\$148), a late payment fee (\$19), a finance charge (\$4), and a luncheon held in connection with a fire information meeting (\$705). These items are normally not allowed as legitimate ratemaking expenses, and Staff did not believe that they qualified as legitimate expenses in this proceeding.

(C) Lobbying

Staff removed \$(1,961) from expenses for lobbying. Ellison stated that Staff does not consider lobbying to be an expense that is necessary to provide utility service, but is a benefit to the shareholders of the Company. The lobbying expense is therefore deducted.

(D) Management Fees

A major adjustment was proposed by Staff on management fees. The Company has an agreement with its parent company, Kiawah Resort Associates, L.P., (KRA), in which KRA provides the utility certain management services. The Company had booked expenses of \$100,000 in management fees during the test year. The Staff's proposed adjustment lowered management fee expenses by \$(64,000). The Staff's adjustment is the same as it was in the Company last rate case. The Order in that case gave a number of reasons for limiting the fee to \$36,000 including possible duplication of services provided by the parent and the direct costs incurred by the Company, lack of a sufficient way of gauging participation by the partners and/or directors of the parent, and lack of proof of the overall reasonableness of the entire fee. The Staff has the same concerns in

this case. The management services agreement is the same agreement that was in effect during the previous case. Some of the services mentioned in the agreement appear to be of the type that a manager or a controller would perform. The utility company already has a manager and a controller on the payroll. The Staff still had difficulty gauging participation of the partners and/or directors of KRA in the affairs of the utility. No minutes of any partner meetings was available for review. The Staff believes that \$36,000 in expenses for management fees is appropriate in this case. The Staff examined time records, payroll records, and documentation of employee benefits in verifying direct labor costs that are associated with management fees. Such direct labor costs totaled \$24,625. Staff recalculated the costs associated with thirty-two partner meetings to be \$8,400. The Staff feels that the Company can document at least \$2,975 in overhead allocations associated with direct labor. Therefore, a management fee of \$36,000 should be used for this case.

(E) Purchased Water

With regard to Staff's adjustment for purchased water, the Company purchases its water from St. John's Water Company, Inc. St. John's purchases its water from the Commissioners of Public Works (CPW) of the City of Charleston, South Carolina. On December 1, 1997, CPW increased its water rates and St. Johns passed this increase along to Kiawah. St. Johns also increased its operations and maintenance charge effective April 24, 1998. The O&M charge is a charge for maintenance of the water lines between Charleston and St. Johns and between St. Johns and the master meter at Kiawah. Such charge is recomputed periodically by St. Johns. In a letter to Ms. Becky Dennis, dated December 31, 1998, St. John's informed the Company that its new rate would be \$1.7306

per one thousand gallons. The letter further stated that the O&M charge would be \$6,687.80 per month. Staff increased purchased water by a total of \$108,853. Staff's adjustment is based on the purchase of 663,752,000 gallons at the rate of \$1.7306 per one thousand gallons or \$1,148,689. The Staff annualized the monthly O&M charges by multiplying \$6,687.80 times 12 months to get an O&M component of \$80,254. The total annual cost of purchased water was therefore computed to be \$1,228,943 on a pro forma basis. The Staff then subtracted the amount booked into the purchased water account during the test year of \$1,120,090. The difference resulted in Staff's adjustment of \$108,853.

(F) Ocean Course Drive Extension

The Commission first approved the Ocean Course Drive extension adjustment in Order No. 92-1030. That Order explained that the adjustment "allows the Company to collect the costs of the Ocean Course Extension over time as the area builds out, as well as depreciate the asset as it is used." The Staff calculated the amount to be included for Ocean Course in the same manner as was used in previous cases. The Staff determined the maximum number of taps for the area to be 410. There are currently 85 existing taps, which equates to an actual capacity rate of 20.73%. The Staff divided the actual capacity rate by the system capacity factor of 75% to determine a system equivalent capacity factor of 27.64%. The original cost of the Ocean Course facility is \$381,564. The Staff computed allowable plant as of the end of the test year to be \$105,464 by applying the system equivalent capacity factor to the original cost of the plant ($\$381,564 \times 27.64\%$). The Staff divided the 27.64% by 7 years to determine allowable plant between test years of 3.95% or \$15,072 per year ($\$381,564 \times 3.95\%$). The Staff used two years between

test years to determine total allowable plant for this case of \$135,608. The Staff removed plant of \$(245,956), accumulated depreciation of \$50,281 and depreciation expenses of \$(5,469). Staff differs with the Company on this adjustment, in that it used two years instead of the Company's three years between rate cases. The test year in the Company's last case was December 31, 1995, while the test year in this case is December 31, 1997.

(G) Repairs and Maintenance Expenses

The Staff analyzed the repairs and maintenance expense account back to 1995 and proposes to amortize only the Company's major repairs and maintenance expenses. The Staff found that in 1995, the only major repair consisted of tank painting in the amount of \$43,014. In 1996, the only major repairs found were \$69,009 to refurbish a well pump, \$39,749 to repair a 16 inch supply line, \$137,000 for sludge removal and \$25,404 in tank painting expenses. The Staff proposes to amortize the sludge removal, tank painting and the supply line repair expenses over five years (\$49,034 per year). The Staff recommends amortizing the refurbishment of the well pump over 15 years (4,601 per year). The total adjustment results in an increase to repairs and maintenance expenses of \$53,635 per year. The Staff determined amortization rates using the frequency intervals contained in a letter dated September 23, 1998 to the Company from Thomas & Hutton Engineering Company.

(H) Legal and Consulting Fees

In Exhibit A-1 of Staff's report, Items 13, 14, 15, 16, 17, and 18 are somewhat interrelated, in that they involve certain legal and/or consulting fees. In items 13 and 14, the Company proposes to use a five-year average of consulting and legal fees in this case. They increased expenses by \$43,493 for consulting fees and \$7,990 for legal fees. The

Staff analyzed legal fees and consultant's fees to determine whether amortization seemed to be an appropriate option. The Staff believes that it is. In item number 15, the Staff recommends removing legal fees amounting to \$7,696 paid during the test year that relate to a fire lawsuit. Such fees should be included in Staff's lawsuit amortization adjustment. The Staff's amortization adjustment included major consulting fees related to a fire and fire studies paid in the amount of \$59,452 in 1995 and \$2,301 paid in 1996. Legal fees relating to the lawsuit include the \$7,696 mentioned above, \$26,265 in 1995 legal fees that were deferred from the last case, plus additional legal fees of \$14,950 paid in 1996. These fees were amortized over five years, resulting in Staff's adjustment of \$22,133.

In Item 17, the Staff removed legal fees related to the appeal of the Company's last rate case by one of its intervenors. The Staff also removed rate case consulting fees from the books. The adjustment to remove legal and consulting fees related to rate cases was \$8,602. These expenses were included in the amortization of rate case expenses contained in item number 18. In that item, the Staff proposed to amortize rate case expenses from the Company's previous case, its appeal, and actual expenses documented thus far for this case. The expenses related to the previous case consists of legal fees of \$56,784, postage of \$1,366, engineering testimony of \$8,108 and \$1,133 for accounting support services. Legal expenses paid during the test year associated with the appeal of the last case totaled \$8,416. Total expenses for that docket and its appeal paid through the end of the test year were \$75,807. The Company had additional legal expenses of \$28,528 associated with the appeal that were paid in 1998 that the Staff did not include in its amortization. The Company documented rate case expenses of \$19,986 that were paid in 1998 for the current case. The Staff included such expenses in its amortization for this

case. The Staff's amortization includes \$95,793 (\$75,807 associated with the last case and its appeal, plus \$19,986 for the current case) divided by 3 years. The adjustment is \$31,931.

Costs from the Company's last case were not included as an expense in the previous case because the Company had not provided timely data to the Commission making it difficult to quantify a reasonable adjustment. The Company paid the majority of the \$75,807 associated with that case after the hearing date. Staff is including costs for more than one case in its amortization of rate case expenses for a good reason. When rate case expenses are amortized over a number of years, it is not unusual to have costs associated with overlapping cases included in amortization amounts. This happens when a utility seeks additional rate relief prior to the end of the previous case's amortization period.

(I) Bad Debt Expense

With regard to bad debt expense, the amount included during the test year totaled \$1,754. This was part of a schedule of bad debts totaling \$2,157.32. The Company collected \$153.72 from the schedule leaving \$2,003.60 outstanding at December 31, 1997. The Staff proposes to amortize this amount over a three-year period since the outstanding debts date back as far as February 7, 1995. Therefore, Staff proposes to allow \$668 (\$2003.60 divided by 3). The adjustment is \$(1,086).

(J) Depreciation and Amortization

In item 20, the Company had made a correcting entry to depreciation expenses and accumulated depreciation during the test year for a previous year. The effect of the correcting entry needed to be reversed to state book depreciation expense for 1997 at the

proper level. However, the debit to accumulated depreciation needs to remain intact so that the reserve account will remain stated at the corrected level.

In item 21, Staff lowered depreciation and amortization expenses by \$10,660 to remove the amount of loan renewal fees that were included in expenses. The Staff proposes to treat such fees as a reduction in loan proceeds when computing cost of debt.

(K) Cash Working Capital

In item 23, Staff adjusted cash working capital for items that correct the books. This has the effect of keeping cash working capital on a per book basis. Cash working capital was computed by Staff using one-eighth of operating and maintenance expenses as seen on Staff Exhibit A-3. The one-eighth formula approach is based on a 45 day cash working capital allowance. The Staff found that the Company bills its customers after it renders service to them. The average bill contains 30 days worth of service. It takes an additional 5 days after rendering service for the utility to read the meters, edit bills, and perform re-reads, and then print and mail the bills out to its customers. The utility then receives payment from its customers within about 15 days. The customer is allowed 25 days from the statement date to pay before late charges are assessed. Staff believes that the above justifies the use of 45 days in the formula. The Company has not conducted a lead lag study for this case.

(L) Customer Growth

In item 24, the Staff adjusted customer growth for the effect of accounting and pro forma adjustments. The Staff used customers at the beginning and end of the test year in its growth calculations. The Staff made two adjustments that contained amounts that extended beyond the end of the test year. One involved plant additions after year

end. The type of additions involved in that adjustment were of a non-revenue producing nature. The other adjustment involved rate case expenses for this current case that were recently paid by the Company. Therefore, Staff did not go beyond the end of the test year in computing the growth factor.

(M) Miscellaneous

In item 26, Staff proposes to eliminate legal fees and construction work in progress (CWIP) associated with the Eugenia Avenue sewer main extension project. In Docket No. 97-497-S, Order No. 98-149, dated February 25, 1998, the Commission approved a sewer main extension fee for Eugenia Avenue customers to cover such costs.

In items 28 and 30, Staff adjusted gross receipts taxes and customer growth for the effects of the proposed increase.

(N) Income Tax Effect

In item number 29, Staff computed the income tax effect caused by the proposed increase in revenue. Staff deducted synchronized interest expense of \$434,358 in computing such taxes. The amount of synchronized interest expense becomes \$421,458 after the effect of the adjustments to capitalize total tap fees of \$140,500 and include the sale of the Ocean Course well.

It should be noted that Staff computed income taxes using a standard method of computing taxes for ratemaking purposes. It ignores the fact that the Company's 1997 U.S. corporation income tax return contains net operating loss carryovers dating back to 1982 in the amount of \$2,355,129 that can be used to offset future taxable income. In 1998, the net operating loss deduction for the year 1982 in the amount of \$189,458 will expire and the December 31, 1997 net operating loss deduction of \$140,286 will be

added. Net operating loss (NOL) deductions are carried forward for fifteen years. The Staff did not use the NOL deduction in computing income taxes for this case. The Staff used an approach where each year stands on its own. The stand-alone approach is often used for ratemaking purposes and it has been used in past cases involving this utility. However, witness Ellison pointed out that if the Commission used NOL carryovers to offset taxable income in this case then no income tax expense would be allowed. The effect on Staff's report would be to increase the operating margin to 12.64%. However, due to a change in ownership interests in January 1997 the utilization of such loss carryforwards is limited. The exact amount of the limit was uncertain at the time of the hearing. The Commission finds that, based on the amount of increase approved herein that the Company will not continue to operate at a loss and will incur taxable income in the future. The use of prior year's Net Operating Loss carry forwards is in question. An uncertainty exists concerning the dollar amount of such carry forwards, if any, that can be used to offset future taxable income. Therefore, the Commission finds that the Staff's calculation of income taxes is an appropriate adjustment for this case.

(O) Sale of Ocean Course Well

There is one subsequent event that occurred recently that must be mentioned. The Company recently sold the Ocean Course well to one of its customers. The Staff's report does not contain an adjustment for the sale of the well. The effect of the sale on the Staff's Report is to remove revenue of \$(97,653), expenses of \$(26,496), plant in service of \$(494,805), accumulated depreciation of \$81,634 and cash working capital of \$(1,295) attributable to the well on an as adjusted basis. The Commission finds that the sale of the

Ocean Course well is a known and measurable change that occurred prior to the hearing date that should be recognized for purposes of this proceeding.

(P) Removal of Capitalized Tap Fee Expenses

Staff proposes to remove \$140,500 in tap fees from the Company's revenue and from its rate base. Hearing Exhibit 13, Accounting Exhibit A-1. The Company accepted this adjustment with the other Staff adjustments. However, Staff witness Ellison also testified that he found no payments to outside contractors for any costs associated with water or sewer taps. Accordingly, all expenses associated with such taps are included in the Company's operating expenses. According to the Town of Kiawah Island's Brief, in order to properly calculate an operating margin in this case, where tap fees of \$140,500 have been removed from revenues, a similar figure must be removed from Operating Expenses. The Town of Kiawah submitted that we should include this adjustment in order to properly match expenses with revenues, and calculate the proper operating margin. We agree, and hereby hold that \$140,500 shall be removed from both revenues and operating expenses, and capitalized into the Company's rate base. Depreciation on the capitalized amount will not be allowed since a contribution in aid of construction of \$140,500 is in rate base as an offset to the amount capitalized.

Based on the accounting and pro forma adjustments herein approved, the Company's appropriate Net Income for Return for the computation of an appropriate operating margin is \$453,605. The calculation of net income for return is shown in Table A:

TABLE A

NET INCOME FOR RETURN – AS ADJUSTED

Operating Revenues	\$3,061,700
Operating Expenses	<u>2,616,752</u>
Net Operating Income	444,948
Customer Growth	<u>8,657</u>
Net Income for Return	<u><u>453,605</u></u>

The following reconciliation leads to the Net Income for Return contained in the above table:

TABLE B

Net Income for Return – As Adjusted Staff Exhibit A:	\$402,138
Eliminate Depreciation Expense on Tap Fees	696
Eliminate Additional Tap Fee Expenses	126,583
Eliminate Revenue from Sale of Well	(97,653)
Eliminate Expenses from Sale of Well	26,496
Income Tax Effect	(5,600)
Customer Growth Effect	<u>945</u>
Net Income for Return – Table A	<u><u>\$453,605</u></u>

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF

FACT NOS. 12, 13, AND 14

Under the guidelines established in the decisions of Bluefield Waterworks and Improvement Company v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), and Federal Power Commission v. Hope Natural Gas, 320 U.S. 591 (1944), this Commission does not ensure through regulation that a utility will produce net revenues. As the United States Supreme Court noted in the Hope Natural Gas decision, supra, the utility “has no constitutional rights to profits such as are realized or anticipated in highly

profitable enterprises or speculative ventures.” However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues “sufficient to assure confidence in the financial soundness of the utility and ... that are adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.” Bluefield, *supra*, at 692-693.

Neither S.C. Code Ann. Section 58-5-240 (Supp. 1998), nor any other statute describes a particular method to be utilized by the Commission to determine the lawfulness of the rates of a public utility. For ratemaking purposes, this Commission examines the relationships between expenses, revenues, and investment in a historic test period because such examination provides a constant and reliable factor upon which calculation can be made to formulate the bases for determining just and reasonable rates. This method was recognized and approved by the South Carolina Supreme Court for ratemaking purposes involving utilities in Southern Bell Telephone and Telegraph Company v. The Public Service Commission of South Carolina, 270 S.C. 590, 240 S.E. 2d 278 (1978).

For water and sewer utilities, the Commission may decide to use the “operating margin” as a guide in determining just and reasonable rates, instead of examining the utility’s return on its rate base. The operating margin is determined by dividing total income for return (or net operating income), minus interest expense, by the operating revenues of the utility.

The Commission finds that its use of the operating margin has resulted in fair rates to both the utility and the ratepayer. In this proceeding, the Commission will use

the operating margin as a guide in determining the lawfulness of the Company's proposed rates, and the fixing of just and reasonable rates. This method was recognized as an acceptable guide for ratemaking purposes in Patton v. South Carolina Public Service Commission, 280 S.C. 288, 312 S.E. 2d 257 (1984). The following Table indicates the Company's gross revenues for the test year under the presently approved rate schedules; the Company's operating expenses for the test year; and the operating margin under the presently approved schedules for the test year:

TABLE C

OPERATING MARGIN-AS ADJUSTED

Operating Revenues	\$3,061,700
Operating Expenses	<u>\$2,616,752</u>
Net Operating Income	444,948
Customer Growth	<u>8,657</u>
Net Income for Return	<u>453,605</u>
Operating Margin After Interest of \$421,458	<u>1.05%</u>

The Commission is mindful of those standards delineated in the Bluefield decision, supra, and of the balance between the respective interests of the Company and of the consumer. The Commission has considered the spectrum of relevant factors in this proceeding, including, among others: the revenue requirements for the Company, the price for which the Company service is rendered, as well as the proposed price, the quality of that service, and the effect of the proposed price upon the consumer.

The three fundamental criteria of a sound rate structure have been characterized as follows:

...(a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost apportionment objective which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or consumer rationing objective under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between costs incurred and benefits received.

Bonbright, Principles of Public Utility Rates, (1961), p. 292.

The Commission considered the proposed increase presented by the Company in light of the various standards to be observed and the interests represented before the Commission. The Commission has also considered the impact of the proposed increase on the ratepayers of the Company. The Commission must balance the interest of the Company – the opportunity to make a profit or earn a return on its investment, while providing adequate water and sewer service – with the competing interest of the ratepayers – to receive adequate service at a fair and reasonable rate. In balancing these competing interest, the Commission has determined that the proposed schedule of rates and charges is unjust and unreasonable and inappropriate for both the Company and its ratepayers.

In light of those factors as previously discussed, and based upon the record in the instant proceeding, the Commission concludes that a fair operating margin that the Company should have an opportunity to earn is 6.50% which requires annual operating revenue of \$3,361,814. The following Table reflects an operating margin of 6.50%:

TABLE D

OPERATING MARGIN-AS APPROVED

Operating Revenues	\$3,361,814
Total Expenses	<u>2,734,262</u>
Net Operating Income	627,552
Customer Growth	<u>12,307</u>
Net Income for Return	<u>639,859</u>
Operating Margin After Interest of \$421,458	<u>6.50%</u>

The Commission is mindful of the testimony of Company witness Barry Gumb, who opined that a 9.5% operating margin was appropriate for the Company. We note that the last operating margin received by this Company was 3.55%, which the Company did not appeal. Further, although Gumb mentioned operating margins for two other utility companies in his testimony, on cross-examination, he admitted that he did little to determine the comparability of those companies to Kiawah. For these reasons, we do not find Gumb's testimony credible.

We believe that our operating margin is supported by the level of income and revenue determined after a thorough examination of the appropriate accounting and pro forma adjustments. Clearly, our approved operating margin falls within the range of approved operating margins by this Commission, and is within the range of reason for water and sewer utilities.

EVIDENCE AND CONCLUSIONS FOR FINDINGS

OF FACT NOS. 15 AND 16.

The Commission has examined the testimony of all parties with regard to rate design in this matter, and we will herein explain our conclusions and our reasoning therefor.

The testimony of Company witness Townsend Clarkson explained the Company's requested rate design, and discussed the Company's usage analysis that estimated the effect of the proposed rates on residential customers at various levels of consumption of water. Clarkson noted that the average domestic use of water is approximately 11,000 gallons per month. Accordingly, the Company proposes a tiered system for all customers. According to Clarkson, a tiered approach minimizes the effect of the rate increase on the residential consumer who consumes water for the ordinary uses in running a household. The Company considers usage over 11,000 gallons to be discretionary. Thus, the Company espouses the philosophy that customers who choose to use more water than the average should pay more, such as those customers who use potable water for irrigation. The utility also states its belief that a tiered consumption rate would encourage water conservation. (See also the testimony of Company witness Becky Dennis.) The Company also requests an increase in the various water basic facilities charges.

Clarkson explained that the Company is proposing to decrease the basic facilities charge for sewer from \$22.00 to \$18.00 per month for residential customers with a standard water meter, and to add a consumption charge of \$.47 per thousand gallons for all gallons of water usage up to 11,000 gallons per month. According to the Company,

customers using less than about 8,500 gallons of water per month will have a lower sewer cost, and customers using above 8,500 gallons per month will have a higher sewer cost.

Clarkson also elaborated on the fact that the Company had performed a fixed versus variable cost analysis to determine the true cost of providing each category of service. Clarkson noted that proposed rates were then calculated from the fixed and variable costs for each category of customer.

Company witness Azari elaborated on the cost study. (See Exhibit D-4 to the Application and Hearing Exhibit 4.) Costs were separated into three main categories: water, sewer and golf. Golf was further split into potable water, effluent water and well water. For the fixed rate, the Company took the total fixed costs for each segment of customers and divided it by the number of customers. For the variable costs, the Company took those costs and divided by the number of gallons for each segment of customers. No profit margin was added for the fixed rates, although a 9.5% profit margin was added to the variable costs. The Company's rates, after certain adjustments, were then calculated directly from the cost analyses for the various classes of customers.

We are aware of opposition to the Company's proposed rates and rate structure by the various intervenors. Jean Hiestand of KPOG opined that no increase should be allowed until the Supreme Court completed its consideration of the Company's last rate case. William Miller of the Town of Kiawah had difficulties with the Company's 11,000 gallon average usage figure, the conservation policy espoused by the Company, the new structuring of the water and sewer rates, and the amount of the proposed increase. Vaughan E. Delk of the Kiawah Island Community Association testified that its annual assessments of the property owners would be insufficient to cover the proposed increase

to be charged against the Association. We are also cognizant of the testimony of Walter T. Cuthbert and John Weitz (who adopted the testimony of Prem A. Devadas), who discuss the effects of the proposed rates on the various golf courses and the Kiawah Island Inn.

However, on reflection, we believe that the rate structure based on cost as proposed by the Company is proper, including the 11,000 gallon average usage figure. The increases proposed do appear to be based on the costs of the Company to serve the various classes of customers. We do note, however, that after accounting adjustments, we are granting only approximately 60% of what was requested by the Company.

We do not believe that KPOG's assertion that the Supreme Court must rule on the prior rate case is consistent with the law. We also disagree with the assertions of the Town of Kiawah, and hold that the Company testimony is more credible on the issues raised by the Town.

Further, we hold that the proposed rates and charges would not impose an unreasonable burden on the Association. The Company's consumption rates for potable water irrigation have increased at a lower rate than the assessments of the Association. (See Delk testimony at 321-322.) In addition, the Association would pay the same rate as the other irrigation customers of the utility.

Also, we hold that the proposed change in rates and charges for the golf and hotel categories of service are fair and reasonable in light of the utility's costs of furnishing these services. The proposed rates and charges for the golf category are based on the actual cost of the three sources of golf irrigation. According to the Company, the proposed increase amounts to an effective increase per round of golf of \$1. (See

Company Brief at 17.) Likewise, with regard to the rates and charges for the hotel and motel service, the proposed rate adjustments amount to \$.48 per occupied roomnight, based on the test year. (See Brief of the Company at 21.) Since the rates in these categories was developed based on the actual cost of service to these categories, we believe that the Company's rate proposals for these categories are appropriate.

Specifically, we are approving the rates and charges proposed by the Company for water and sewer as just and reasonable, with one exception. With regard to the consumption charges under the water category for Rate Schedule No. 1 Residential Service, the Company has proposed \$2.17 per 1,000 gallons for all water consumed over 2,000 gallons per month and up to 11,000 gallons per month, \$2.65 per 1,000 gallons for all water consumed over 11,000 gallons per month and up to 50,000 gallons per month, and \$2.90 per 1,000 gallons for all consumption over 50,000 gallons per month. We believe that these charges are unjust and unreasonable, and should be modified to the following: \$2.10 per 1,000 gallons for all water consumption over 2,000 gallons per month and up to 11,000 gallons per month, \$2.20 per 1,000 gallons for all water consumed over 11,000 gallons per month and up to 50,000 gallons per month, and \$2.41 per 1,000 gallons for all water consumed over 50,000 gallons per month. We hold that these figures still minimize the effect of the rate increase on the average consumer of water, while still promoting conservation of water, which we believe is a worthwhile goal. They also reflect the reductions in revenue due to accounting adjustments.

We also approve all rate changes proposed to the miscellaneous service charges.

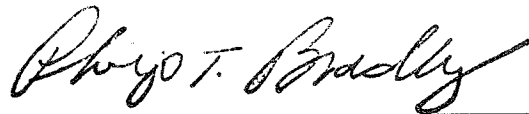
The overall approved rates and charges approved by this Commission are depicted in Appendix A attached hereto and incorporated by reference. They are

approved and effective for service rendered on or after the date of this Order. We believe that the rates and charges approved herein achieve a balance between the interests of the Company and those of its customers. These rates and charges result in a reasonable attainment of the Commission ratemaking objectives in light of applicable statutory safeguards.

IT IS THEREFORE ORDERED THAT:

1. The proposed schedule of rates and charges as filed in the Company's Application is found to be unreasonable, and is hereby denied.
2. The schedule of rates and charges attached hereto as Appendix A is hereby approved for service rendered on or after the date of this Order. The schedule is deemed filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240 (Supp. 1998).
3. The Company shall maintain its books and records in accordance with the NARUC Uniform System of Accounts as adopted by this Commission.
4. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:



Chairman

ATTEST:


Executive Director

(SEAL)

Appendix A

**KIAWAH ISLAND UTILITY, INC.
31 Sora Trail Rd.
Johns Island, SC 29445
(843) 768-0641**

**FILED PURSUANT TO DOCKET NO. 98-328-W/S – ORDER NO. 1999-216
EFFECTIVE DATE: MARCH 31, 1999**

SCHEDULE OF PROPOSED RATE SCHEDULE AND CHARGES

RATE SCHEDULE NO. 1 RESIDENTIAL SERVICE

AVAILABILITY -- Available within the Company's service area.

APPLICABILITY -- Applicable to any residential customer for any purpose.

Water Service Charges

A.	Minimum Bill 0-2,000 gal./mo.	
	5/8" meter	\$ 22.40/mo.
	3/4" meter	\$ 33.60/mo.
	1" meter	\$ 56.00/mo.
	1 1/2" meter	\$112.00/mo.
	2" meter	\$179.20/mo.
	3" meter	\$392.00/mo.

Basic Facilities Charge for water service with meters larger than 3" shall be:
Maximum recommended meter capacity (gpm) x \$22.40 per mo.
20 gpm

B.	Consumption Charge	\$ 2.10/1000 gal.
	All over 2,000 gal./mo. and up to 11,000 gal./mo.	
C.	Excess Consumption Charge #1	\$ 2.20/1000 gal.
	All over 11,000 gal./mo. and up to 50,000 gal./mo.	
D.	Excess Consumption Charge #2	\$ 2.41/1000 gal.
	All over 50,000 gal./mo.	

Sewer Service Charges

A.	Basic Facilities Charge	
	5/8" water meter	\$ 18.00/mo.
	3/4" water meter	\$ 27.00/mo.
	1" water meter	\$ 45.00/mo.
	1 1/2" water meter	\$ 90.00/mo.
	2" water meter	\$144.00/mo.
	3" water meter	\$315.00/mo.

Basic Facilities Charge for sewer service where water service is through meters larger than 3" shall be:

$$\frac{\text{Maximum recommended meter capacity (gpm)} \times \$18.00 \text{ per mo.}}{20 \text{ gpm}}$$

B.	Consumption Charge Based on Water Usage	\$.47/1000 gal.
	All up to 11,000 gal./mo.	

Tap-in Fees

Water tap-in fee	\$500.00
Sewer tap-in fee	\$500.00

The tap-in fee provides for installation of the normal size residential meter of 5/8" by 3/4". Where the customer requests a larger meter, Company will apply the tap-in fee schedule for larger meters as listed in the Commercial Service Schedule No. 2.

RATE SCHEDULE NO. 2 COMMERCIAL SERVICE

AVAILABILITY -- Available within the Company's service area.

APPLICABILITY -- Available to any Commercial or Master Metered Residential Customer for any purpose except Hotel or Motel use (see Rate Schedule No. 3).

Water Service Charges

A.	Basic Facilities Charge	
	5/8" meter	\$ 22.40/mo.
	3/4" meter	\$ 33.60/mo.
	1" meter	\$ 56.00/mo.
	1 1/2" meter	\$112.00/mo.
	2" meter	\$179.20/mo.
	3" meter	\$392.00/mo.

Basic Facilities Charge for water service with meters larger than 3" shall be:

$$\frac{\text{Maximum recommended meter capacity (gpm)} \times \$22.40 \text{ per mo.}}{20 \text{ gpm}}$$

B.	Consumption Charge	\$2.41/1,000 gal. for all consumption
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Sewer Service Charges

A.	Basic Facilities Charge
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5/8" meter	\$ 18.00/mo.
3/4" meter	\$ 27.00/mo.
1" meter	\$ 45.00/mo.
1 1/2" meter	\$ 90.00/mo.
2" meter	\$144.00/mo.
3" meter	\$315.00/mo

Basic Facilities Charge for sewer service where water service is through meters larger than 3" shall be:

Maximum recommended meter capacity (gpm) X \$18.00 per mo.
20 gpm

B. Consumption Charge \$1.80/ 1000 gal.
for all consumption

Tap-in Fees

		<u>Water Tap-in Fee</u>	<u>Sewer Tap-in Fee</u>
5/8"	meter	\$ 500.00	\$ 500.00
3/4"	meter	\$ 750.00	\$ 750.00
1"	meter	\$1,250.00	\$1,250.00
1 1/2"	meter	\$2,500.00	\$2,500.00
2"	meter	\$4,000.00	\$4,000.00
3"	meter	\$8,750.00	\$8,750.00

Water Tap-in Fee and Sewer Tap-in Fee for water and sewer service where the water meter is larger than 3" shall be:

Maximum recommended meter capacity (gpm) X \$500.00
20 gpm

RATE SCHEDULE NO. 3 HOTEL AND MOTEL SERVICE

AVAILABILITY -- Available within the Company's service area.

APPLICABILITY -- Applicable to all hotel and motel customers for any purpose.

Water Service Charges

Basic Facilities Charge	\$9.00/mo/room
All Consumption	\$2.41/1000 gal

Sewer Service Charges

Basic Facilities Charge	\$7.20/mo/room
All Consumption	\$1.80/1000 gal

Tap-in Fees

Water Tap-in Fee	\$220/room
Sewer Tap-in Fee	\$220/room

RATE SCHEDULE NO. 4 IRRIGATION SERVICE

AVAILABILITY -- Available within the Company's service area. The Company reserves the right to limit or reduce irrigation service available when, in its sole judgment, its water system conditions require such restrictions.

APPLICABILITY -- Applicable only to customers who anticipate substantial potable water use which will not be returned to the Company's wastewater treatment system such as irrigation. Such water consumption shall be metered separately from any water use supplied under other rate schedules.

Water Service Charges

A.	Basic Facilities Charge	
	5/8" meter	\$ 22.40/mo.
	3/4" meter	\$ 33.60/mo.
	1" meter	\$ 56.00/mo.
	1 1/2" meter	\$112.00/mo.
	2" meter	\$179.20/mo.
	3" meter	\$392.00/mo.

Basic Facilities Charge for water service with meters larger than 3" shall be:

Maximum recommended meter capacity (gpm) X \$22.40 per mo.
20 gpm

B.	Consumption Charge	\$ 2.20/1000 gal.
	All up to 50,000 gal./mo.	
C.	Excess Consumption Charge	\$ 2.41/1000 gal.
	All over 50,000 gal./mo.	

Tap-in Fees

5/8" meter	\$ 500.00
3/4" meter	\$ 750.00

1" meter	\$1,250.00
1 1/2" meter	\$2,500.00
2" meter	\$4,000.00
3" meter	\$8,750.00

Water Tap-in Fee where the water meter is larger than 3" shall be:
Maximum recommended meter capacity(gpm) X \$500.00
 20 gpm

RATE SCHEDULE NO. 5 FIRE HYDRANT SERVICE

AVAILABILITY -- Available within the Company's service area.

APPLICABILITY -- Applicable to fire hydrants connected to Company water mains.

Water Service Charges

\$100.00 per hydrant per year payable semiannually in advance for fire fighting service.

When temporary water service from a hydrant is requested by a contractor or others, a meter will be installed and the charge will be:

\$8.00 for each day of use, PLUS \$2.41/1000 gals. for ALL water used, PLUS a \$50 security deposit.

RATE SCHEDULE NO. 6 GOLF COURSE IRRIGATION

AVAILABILITY -- Available within the Company's service area.

APPLICABILITY -- Applicable for golf course irrigation where the customer agrees to take as a minimum quantity the treated effluent from the wastewater treatment plant.

Water Service Charges

A. Effluent water will be billed at the rate of:

Basic Facilities Charge	\$14,944.00/mo.
Consumption	\$.13/1000 gal.

B. Deep well water will be billed at the rate of:

Basic Facilities Charge	\$3,480.00/mo.
Consumption	\$.18/1000 gal.

C. Potable water will be billed at the rate of:

Basic Facilities Charge
Consumption

\$2,663.00/mo.
\$2.41/1000 gal.

RATE SCHEDULE NO. 7 FIRE LINE SERVICE

AVAILABILITY -- Available within the Company's service area.

APPLICABILITY – Applicable for private fire lines.

Water Service Charges

Basic Facilities Charge

2" line	\$ 6.00/mo.
3" line	\$11.00/mo.
4" line	\$19.00/mo.
6" line	\$38.00/mo.

Tap-in Fees

2" line	\$4,000.00
3" line	\$8,750.00

Water Tap-in Fee where the service is larger than 3" shall be based on the tap-in fee schedule as listed in the Commercial Service Schedule No. 2.

CHARGES FOR SERVICE DISCONTINUANCE, RECONNECTION AND OTHER MISCELLANEOUS SERVICE CHARGES

1. When a customer requests temporary discontinuance of service for the apparent purpose of eliminating the minimum bill, during such cut-off period the Company may make a charge equivalent to a three months minimum bill for both water and sewer service and require payment of such charge before service is restored.
2. Temporary discontinuance of service for such purposes as maintenance or construction will be made and the Company may charge the customer the actual cost plus 25%.
3. Whenever service is disconnected for violation of rules and regulations, nonpayment of bills or fraudulent use of service, the Company may make a charge of \$25.00 for water and \$100.00 for sewer before service is restored.
4. Whenever service has been disconnected for reasons other than set forth in (3) above, the Company shall have the right to charge a \$25.00 reconnection fee to restore service after 4:30 p.m. Monday-Friday or

Saturday/Sunday.

5. Delinquent Notification Fee - \$10.00. A fee of \$10.00 shall be charged each customer to whom the Company mails a notice of discontinuance of service as required by the Commission rules prior to service being discontinued. This fee assesses a portion of the clerical and mailing costs of such notices to the customers creating that cost.
6. Customer Account Charge - \$25.00. One-time fee charged to each new account to defray costs of initiating service.
7. Return Check Charge (NSF) - \$20.00.
8. Backflow Monitoring - \$0.20 per month. A fee of \$0.20 per month shall be charged each customer to reimburse the Company for Backflow Monitoring required by DHEC regulations.
9. DHEC Charges. If the South Carolina Department of Health & Environmental Control charges the Company an assessment based on customer units served by the Company, the Company may bill its customers for the applicable unit cost of that assessment. The charge shall be identified as a separate billed item and included in the total of the service billing.